No. 2879

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

FRANK P. McKINNEY, as Receiver of the OLYMPIA BANK & TRUST COMPANY, a Corporation,

Appellant,

vs.

UNITED STATES NATIONAL BANK OF CENTRALIA, a Corporation, and A. R. TITLOW, as Receiver of the UNITED STATES NATIONAL BANK OF CENTRALIA,

Appellees,

and

C. S. REINHART and C. WILL SHAFFER, Stockholders of OLYMPIA BANK & TRUST COMPANY, a Corporation, for Themselves and All Other Stockholders of Said Company,

Appellants,

vs.

UNITED STATES NATIONAL BANK OF CENTRALIA, a Corporation, and A. R. TITLOW, as Receiver of the UNITED STATES NATIONAL BANK OF CENTRALIA,

Appellees,

and

ROY A. LANGLEY, as Receiver of the STATE BANK OF TENINO,

Appellant,

vs.

UNITED STATES NATIONAL BANK OF CENTRALIA, a Corporation, and A. R. TITLOW, as Receiver of the UNITED STATES NATIONAL BANK OF CENTRALIA,

Appellees.

BRIEF OF INTERVENORS AND APPELLANTS

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION.

C. WILL SHAFFER,
Solicitor for Intervenors.

Business and Postoffice Address:
Olympia, Washington.

THE WASHINGTON STANDARD PRINT, OLYMPIA, WASH.

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INTERVENOR'S STATEMENT.

In the action brought by the receiver of the Olympia Bank and Trust Company against the United States National Bank of Centralia and A. R. Titlow, its receiver, C. S. Reinhart and C. Will Shaffer, stockholders and directors in the Olympia Bank and Trust Company, with the consent of the court and the receiver of the Olympia Bank and Trust Company, intervened in order that the court might have certain equitable phases of the case presented, deemed by the receiver inconsistent, or possibly so, with his causes of action.

The suddenness with which the Olympia Bank and Trust Company sprang into existence and its brief career, and the collapse of so many financial institutions in Southwestern Washington, coincident with the closing of the doors of the United States National Bank, is a story that can probably be best understood if stated in a narrative form.

Olympia, Tenino and Centralia are the localities and C. S. Gilchrist and W. Dean Hays the leading characters in this financial drama.

Springing meteor-like out of the wilderness, about thirty miles south of Olympia, on the main line of the Northern Pacific Railway between Seattle and Portland, is the now beautiful little city of Centralia, with its twelve to fifteen thousand people, well-laid-

out paved streets, fine homes and substantial business blocks. Branch railroads radiate to all parts of Southwestern Washington—fifty-some passenger trains daily entering or departing from the city. Immense sawmills are located here and large logging concerns do business from this point; lignite mines have been opened nearby and hundreds of thousands of tons of coal are shipped each year; in fact, a real, live, prosperous, business city in a very few years from what was once an almost impenetrable forest.

Centralia's wonderful growth was due in no small measure to the faith and enterprise of one man and one business institution. C. S. Gilchrist opened a small bank in Centralia shortly after the town started. He saw that the wonderful natural resources surrounding the place, if developed and reduced to useful form, meant prosperity for all. His bank grew as the city grew until soon it was a national bank, and but a little later the leading financial institution in Southwestern Washington, with deposits far above a million dollars; in fact, its business and the demands on it outgrew its limitations under the national banking act, and to meet these situations, allied state banking institutions were organized (see Trans. of Rec., p. 129). Many a prominent business man owed his start in business to Gilchrist and his bank; many a big business concern was kept going

by the ready accommodation and encouragement of the United States National Bank. (Note some of these transactions in the testimony of Mr. Hill, bookkeeper for the receiver, Trans. of Rec., p. 106; in testimony of Mr. Gilchrist, Trans. of Rec., p. 124.)

In Thurston County, between Olympia and Centralia, but slightly nearer the latter, is Tenino, a little sawmill and stone quarry town of about 1,500 people. In a business sense, as well as a geographical sense, Tenino was equally nearer Centralia, though tied politically to Olympia, its county seat and the state capital.

W. Dean Hays came to Olympia along about 1905, endeavoring to negotiate the purchase of the Olympia National Bank. He went into banking in Centralia and Chehalis for a short time, then purchased the Tenino State Bank. (See Trans. of Rec., p. 67.)

He became a prominent man in this section of the state. He was elected on the Republican ticket to the legislature in 1912 and was renominated in 1914. He owned a fine country villa and one of the finest houses in Olympia; he had an accomplished and talented family.

It appears that in July, 1914, Hays sold his bank in Tenino to C. S. Gilchrist, or to the United States National Bank. (See Trans. of Rec., p. 67). Hays

says: "In July, I sold my stock in the Tenino State Bank to Mr. Gilchrist and went away. He sent a man to take my place." (Trans. of Rec. p. 67, and especially latter part of page 67 and top of page 68.) Mr. Gilchrist infers this was not the fact, but nevertheless, he testifies:

"We had sent Mr. Daubney up to assist in the managing of the Tenino Bank." (Trans. of Rec., p. 115.)

And Gilchrist and Daubney came to Tenino to examine the bank before that. (Trans. of Rec., p. 68.)

Hays and Gilchrist had for years been very intimate, in fact, Hays seemed to be more the agent of Gilchrist than a free-acting business man. He says:

> "Was connected in business, association, and commercial association with the United States National Bank." (See Trans. of Rec., p. 67.)

Gilchrist was, in fact, the United States National Bank's active manager. His father was a director, but took little active part; his cashier, Mr. J. W. Daubney, was also a director; Mr. C. S. Gilchrist was a director, first vice president and the active manager; Mr. George W. Dysart was the second vice president and director, while the fifth director was Mr. J. A. Vaness (Trans. of Rec., p. 113; see also cross-

examination of Mr. Gilchrist, Trans. of Rec., p. 125, and testimony of Mr. Dysart, Trans. of Rec., p. 115).

The United States National Bank became much in need of actual cash (see testimony of Trustee Dysart, Trans. of Rec., p. 113; and of Mr. Hill, showing some of the firms indebted and failed, Trans. of Rec., p. 116; and that of C. S. Gilchrist, Trans. of Rec., p. 124).

Olympia is the state capital; the state treasurer has four or five millions of dollars to distribute among the deposit banks. The state treasurer was a Republican; W. Dean Hays was of the same political faith, member of the state legislature and sure of re-election. Gilchrist came to Olympia many times to consult Hays about starting a bank in the capital city. (See Trans. of Rec., Pp. 125-6, his own testimony, and testimony of Hays, Trans. of Rec., Pp., 68-70.) He, the active manager and director, took his cashier, who was also director on August 19th, 1914, the day the articles of incorporation of the Olympia Bank and Trust Company were filed (see Trans. of Rec., Pp. 151-2) and there in Olympia, some thirty miles away from the bank, gave W. Dean Hays an affidavit to the effect that the Olympia Bank and Trust Company had on deposit in the United States National Bank the sum of $50,000.00. (See Trans. of Rec., p. 170.)

As a result of these numerous visits of Gilchrist to Hays, the latter approached several men prominent in business and official circles in Olympia, urging them to subscribe for stock in the bank that was about to be organized. Olympia had no institution of the nature of a banking and trust company, and to these men the field seemed a good one, but many of them, while they approved of the idea and hoped to be able to take stock in such institution, did not at that time have the ready cash with which to purchase stock. Hays assured them that he had plenty of funds and would be glad to loan them the money temporarily, as he was anxious to have these men in with him because of their influence in the community. Each prospective stockholder who was in this condition was informed that the transaction was wholly a personal one between him and Hays and that no one else would know anything about it. Much of this solicitation was done by his attorneys, who assured the prospective stockholder that they were going in on that basis. (See Trans. of Rec., p. 96.)

Almost on the day these men were solicited, Hays called a meeting for the purpose of organization. He was anxious to get the bank started. He assured those present that a great many other prominent men desired stock in the bank, but since they could not be present at that meeting, he would subscribe for the

stock, and later on, if the absentees wished it, he would give the stock to them from his own allotment, and that as the stock had not been issued, he would leave it open so that he could very shortly issue it to them. Thus Capt. C. S. Reinhart, former president of the Olympia National Bank and Clerk of the Supreme Court of the State of Washington, took 15 shares; I. M. Howell, the Secretary of State for the State of Washington and former banker in Tacoma, took 50 shares; W. T. Cavanaugh, for 16 years Postmaster of Olympia, took 10 shares; H. T. Jones, member of the State Board of Control and large property owner, took 10 shares; W. A. Weller, F. G. Blakeslee and Chas. E. Hewitt, prominent business men, each took 10 shares; and C. Will Shaffer, State Law Librarian, 10 shares. Hays made a private deal with each of these stockholders, except Jones and Cavanaugh, to the effect that he was loaning them each money with which to subscribe to the capital stock. (See Trans. of Rec., p. 96.)

On the evening of August 14th, 1914, the stockholders organized by electing C. S. Reinhart president of the bank, I. M. Howell vice president, W. Dean Hays cashier, W. T. Cavanaugh assistant cashier, H. T. Jones chairman of the board of directors, and C. Will Shaffer secretary of the board of directors.

It was represented to these stockholders by Hays and his attorneys that another party was anxious to organize a bank of the same kind and that, if the Olympia Bank and Trust Company was rushed through and opened, such other parties would not enter the field. The bank was ordered opened as soon as quarters could be secured and furniture installed.

On the 19th day of August, C. S. Gilchrist, who had been in close touch with Hays in this situation, came to Olympia with the other director of the United States National Bank and the cashier, Mr. J. W. Daubney, and there gave to Hays a certificate to the effect that the Olympia Bank and Trust Company had on deposit $50,000.00, and made affidavit thereto. (See Trans. of Rec., p. 170.) For this credit of $50,000.00 Hays turned over to Gilchrist $11,450.00 in notes of other stockholders and two of his own notes, one for $12,500.00 and one for $24,050.00. (See Trans. of Rec., p. 68.)

Mr. Gilchrist's own words:

> "During the months of August, 1914, and September, 1914, and until the time the United States National Bank closed its doors, I was actively in charge of the United States National Bank as its vice president. I was the person who managed its business principally. I was the

active manager of the bank; I talked quite frequently with Mr. Hays about the organizing of the Olympia Bank and Trust Company. The *matter* was discussed in Tenino at first, and then at Centralia and at Olympia. I went over to Olympia quite frequently to talk with Mr. Hays about the subject. The $50,000.00 certificate signed by Mr. Daubney was given to Mr. Hays in my presence in Olympia. Mr. Daubney and myself came over to see Mr. Hays about getting the Olympia Bank and Trust Company started. When we got to Olympia, we found that the $36,550.00 certificate had not as yet been subscribed for. It was my understanding that Mr. Hays ultimately was to have $10,000.00 worth of stock and not to exceed $15,000.00, and when we went over the matter with Mr. Hays, we received the understanding that there was $36,550.00 worth of stock which had not yet been subscribed for. I understood that all of the stock of the Olympia Bank and Trust Company had would be paid for before the bank could open up and do business. * * * The understanding that we had with Mr. Hays was that he was to subscribe for the balance of the stock of the Olympia Bank and Trust Company. * * * There was nothing said about the Olympia Bank and Trust Company subscribing for the rest of its own stock * * * that was impossible. He did not tell me that he was subscribing for the

Olympia Bank and Trust Company as cashier of the Olympia Bank and Trust Company—he was subscribing for it in his personal capacity. The stock had not yet been issued; it was about seven to ten days after issuing the $50,000.00 certificate that the stock was turned over to us. We would not certify to the balance of the $50,000.00 until we had something to show for it, so Hays sent the notes for $36,550.00 and we took the other notes given by various organizers of the bank. * * * When we issued the $50,000.00 certificate we received $48,000.00 worth of notes and $2,000.00 in cash. * * * My understanding was that the stock was to be collateral to the two Hays's notes and not for the others. We did not ask for security on the other notes for $11,450.00. I took into consideration the fact that he had associated with him the highest state officials and men who were held in high esteem by me, personally. I was willing to take all the notes given me at the time except the Hays's notes without any security at all. That day when I came up, I was anxious to have the bank started at an early date; to have it started and get through with it." (See Trans. of Rec. pp. 125-126-127).

Again:

"Mr. Hays told me that he subscribed for $36,550.00 worth of stock personally; I had no other means of knowing it except what he told me. I never had any dealings with anyone with

reference to the $48,000.00 worth of notes or to the $50,000.00 worth of credit at the United States National Bank except with Mr. Hays. (See Trans. of Rec. bottom of p. 132 and top of p. 133).

And again, on re-cross-examination:

"I had no agreement with anybody except Mr. Hays—I do not mean to be understood that Mr. Hays was signing the note as trustee for the Olympia Bank and Trust Company. I did not testify on the former trial that Hays had authority to sign as trustee."

The statute relating to banking and trust companies in the State of Washington is as follows:

TRUST COMPANIES, INCORPORATION, POWERS AND DUTIES.

Sec. 3346. "Seven or more persons of full age may become a trust company on the terms and conditions and subject to the liabilities prescribed in this act; the name of every company formed under this act shall contain the word 'trust', but shall not be that of any other existing corporation of this state; the capital stock of such trust company hereafter organized shall not be less than one hundred thousand dollars: Provided, That in cities having less than twenty-five thousand inhabitants such companies may be organized with fifty thousand dollars'

capital, and shall be divided into shares of one hundred dollars each, all of which shall be paid in cash before any trust company shall be authorized to transact any business, and such payment shall be certified to the bank examiner under oath by the president and treasurer or secretary of the trust company; * * *"

(Sec. 3346, Rem.-Bal. Codes and Statutes of Wash.)

Sec. 3348. "The certificate of incorporation shall be acknowledged as required for deeds of real estate, and shall be recorded in a book kept for that purpose in the office of the county auditor where the principal place of business of such trust company in this state is to be established, and with the secretary of state: Provided, however, That before the corporation shall be authorized to transact business in this state other than such as relates to its formation and organization, the bank examiner shall examine, or cause to be examined, in order to ascertain whether the requisite capital of such corporation has been fully paid in cash, and if it appears from such examination that such capital stock has not been fully paid in cash, a certificate of authorization shall not be granted and no such corporation shall commence business until such certificate of authorization has been granted; but when it shall appear to the bank examiner that the entire capital stock has been paid in, and that such trust company is lawfully entitled to commence business he shall give to such company a certificate under

his hand and seal that such company is duly and legally organized under this act as a trust company, and authorized to transact business as such trust company in this state; the trust company shall cause such certificate of authority of the bank examiner, issued in pursuance in this chapter, to be published once a week for at least four successive weeks next after the issuance thereof, in a newspaper of general circulation in the place where said trust company is established, and shall file proof of such publication with the bank examiner."

(Sec. 3348 Rem.-Bal. Anno. Codes and Stat. of Wash., L. '03, p. 368, Sec. 3.)

Sec. 3349. * * * "*As soon as the certificate of authority is issued by the bank examiner as provided in the preceding section, the persons named in the articles of incorporation and their successors shall thereupon and thereby become a corporation and shall have power*: * * *"

(Sec. 3349 Rem.-Bal. Anno. Codes and Stat. of Wash., L. '13, p. 640, Sec. 1.)

Sec. 3296. * * * "Every certificate, assignment and conveyance, executed by the state bank examiner in pursuance of the authority conferred upon him by law, and sealed with the seal of his office, shall be received as evidence. * * *"

(Sec. 3296 Rem.-Bal. Anno. Codes & Stat. of Wash., L. '07, p. 530, Sec. 35.)

In conformity with the above act, the state bank examiner made an examination of the credits of the Olympia Bank and Trust Company and certified from such examination that the stock had actually been paid for in cash and that the corporation had on deposit in a bank, as is required by law, the necessary amount of its capital stock. (See Trans. of Rec. p. 155).

While not in the record, it is a matter of public record in the state of Washington that the governor was of a different political faith from that of W. Dean Hays, and that the bank examiner is appointed by the governor, so that in this particular incident it cannot be reputed that there was collusion between Hays and the state bank examiner.

Thus, did the Olympia Bank and Trust Company start. It had a credit of $50,000.00 in the United States Bank, less $2,500.00 brought over by Mr. Gilchrist. The United States National Bank had received $2,000.00 in cash and $48,000.00 in notes, thus, its cash reserve was practically unimpaired.

The Olympia Bank and Trust Company was opened on the 21st day of August, 1914. (See Trans. of Rec. p. 70). Almost immediately, $15,000.00 was gotten from the state treasury and $5,000.00 from the city of Olympia, and transmitted to the United States National Bank and within 10 days thereafter, over

$20,000.00 more had been transmitted to different places to the credit of the United States National Bank so that by September 1st there had been deposited in the United States National Bank, or to its credit, by the Olympia Bank and Trust Company, according to the statement of the receiver of the United States National Bank, $101,498.91. (See Trans. of Rec. p. 158).

While the financial flotilla over which C. S. Gilchrist was high admiral was drawing nearer the great engulfing whirlpool, Mr. Dysart, the second vice president, had been around over the state trying to get the other banks to take his paper, as he says, to build up their cash reserve on account of the war—but why the Centralia National Bank should require a bigger reserve on account of the war is not stated. On September the 14th, Directors Dysart and Vaness, in their desperation, took charge of the United States National Bank. (See Trans. of Rec. p. 113). They determined the notes of W. Dean Hays were not worth having, though the notes of the other stockholders of the Olympia Bank and Trust Company were good notes. (See Trans. of Rec. pp. 113 and 127). They immediately told Mr. Gilchrist, without holding a formal meeting of the directors, that they did not want Mr. Hays's note, and that they wished to repudiate Mr. Gilchrist's dealings with Mr. Hays,

and that if the Olympia Bank and Trust Company had a credit of some eighty thousand dollars on the books of the United States National Bank, that Gilchrist, the active manager, and Daubney, the cashier, must proceed immediately to Olympia and get drafts from Mr. Hays against the credit of the Olympia Bank and Trust Company sufficient to cover Hays's notes. The other notes held by the bank were good notes and there was no need to worry about that. (Trans. of Rec. p. 127).

At no time did the United States National Bank or its directors repudiate the action of Gilchrist, who was the active manager of that bank as well as a director and its first vice president, when he placed on the books of the United States National Bank a credit to the Olympia Bank and Trust Company in the sum of $50,000.00. This credit was acknowledged in all statements furnished by the United States National Bank while it was a going concern, and was also especially recognized by the receiver in his statement of account issued October 20th, one month after the closing of the doors of the United States National Bank. (See Trans. of Rec. p. 158). This cause was tried in the lower court practically one year and three months after the receivers had taken charge of their respective institutions and it was only near the close of the trial that the receiver of the United States

National Bank offered his repudiation. The trial court held with the receiver of the United States National Bank in this, but refused to hold with the intervenors in that the actual cash deposited in the United States National Bank was a trust fund in favor of the creditors of the Olympia Bank and Trust Company.

ASSIGNMENT OF ERRORS OF INTERVENORS.

The trial court erred:

"First. For refusal to grant the relief prayed for in the complainant's first cause of action, towit, for a credit of $36,550 in the United States National Bank of Centralia, Washington.

Second. For the refusal to grant the relief prayed for in complainant's second cause of action, towit, for a credit of $10,000 in the United States National Bank of Centralia, Washington.

Third. For cancelling and holding void a credit of $48,000 in the United States National Bank of Centralia, Washington, in favor of the Olympia Bank and Trust Company.

Fourth. For returning to the complainant certain notes according to the demand of the complaint of intervention but refusing to es-

tablish a trust fund of moneys deposited in the United States National Bank by the Olympia Bank & Trust Company as demanded by Intervenors' Cause of Action.

Fifth. That all of the claims on the part of the complainant and intervenors to a preferred and prior claim against the assets in the hands of the defendant receiver were denied with prejudice, but should have been allowed.

Sixth. That the complainant was allowed a general claim against the defendant as receiver in the sum of $25,998.91 and no more on the accounting herein, when the complainant should have been allowed the sum of $83,998.91.

Seventh. For holding that the United States National Bank was not bound by the conduct of the managing officers and directors when such officers and directors connived with and demanded of the cashier of the Olympia Bank & Trust Company that he, the cashier of the Olympia Bank & Trust Company, use the funds of the Olympia Bank & Trust Company in the United States National Bank to cancel the private debt of the said cashier in the United States National Bank.

Eighth. That complainant and intervenors were not allowed their costs in said action."

These assignments, with the exception of the fifth and in part the seventh, are coincident with the

assignments of the receiver appellant. The intervenors join in the claim set forth in the appeal on behalf of the receiver of the Olympia Bank & Trust Company and will discuss these assignments therefor in the order named, with particular stress, however, upon the fifth assignment.

SPECIFICATION OF ERROR NO. 1.

Gilchrist testified he was the manager of the United States National Bank:

> "During the months of August, 1914, and September, 1914, and until the time the United States National Bank closed its doors, I was actively in charge of the United States National Bank as its vice president. I was the person who managed the business principally; I was the active manager of the bank." (See Trans. of Rec., p. 125.)

Mr. Dysart, the second vice president and director, testified:

> "Mr. C. S. Gilchrist was the active manager of the bank." (See Trans. of Rec., p. 114.)

In most of the cases cited below, the principle is laid down that the bank is liable for the acts of the cashier, assuming, of course, as in most instances, the cashier is the executive officer of the bank so far as the financial operations are concerned, but with

the United States National Bank, the cashier might be termed assistant manager, both the manager and cashier were directors, but Gilchrist was also first vice president.

Then the active manager, who was first vice president and director, together with the cashier or assistant manager, who was also a director, came to Olympia to urge W. Dean Hays to take a loan from their bank. True, Mr. Gilchrist says he was disappointed that Hays's personal loan was required to be as large as $36,000. He testifies that he was going to loan Mr. Hays $10,000 and hoped not over $15,000.

> "It was my understanding that Mr. Hays ultimately was to have $10,000 worth of stock and not to exceed $15,000, and when we went over the matter with Mr. Hays, we received the understanding that there was $36,550 worth of stock which had not then yet been subscribed for." (See Trans. of Rec., Gilchrist's Testimony, p. 126.)

They, however, made Mr. Hays a larger loan, and it may be contended that the size of this loan was in violation of Section 5200, U. S. Revised Statutes, Bolles Nat. Bk. Act, Anno., 4th Ed., p. 71.

But you will observe that Mr. Gilchrist did not take this note to the United States National Bank

direct from Mr. Hays. He testified in his re-direct examination, as follows:

> "The $24,050 note was charged to the Union Loan & Trust Company. I directed that it be charged to the Union Loan & Trust Company and credited to the Olympia Bank and Trust Company." (See Trans. of Rec., p. 125.)

Thus, for the claim of $50,000, the officers of the United States National Bank received for the bank $2,000 in cash, $11,450 in notes of various persons and one $12,500 note of W. Dean Hays direct to the bank and a claim against the Union Loan & Trust Company for a $24,050 note signed by W. Dean Hays; in other words, the $24,050 note was negotiated through the Union Loan & Trust Company.

The question is, did the officers of the United States National Bank have authority to take these credits, whether good or bad, in exchange for the credits of the United States National Bank to the Olympia Bank and Trust Company?

> "The cashier 'may bind the funds of the bank in matters of contract.' "

I. Michie, Banks and Banking, Sec. 102 (5C).

> "The acts of the cashier of a bank in his capacity as such are binding on the bank."

Burnham vs. Webster, 19 Me. 232.

Badger vs. Bank of Cumberland, 26 Me. 424.

Cooper vs. Townsend, 59 Hun. 624; 13 N. Y. S. 760.

Owens vs. Stapp, 32 Ill. App. 653.

"The cashier of a bank is the financial officer thereof and his agreements in behalf of his principal in all matters relating to its business of banking are binding upon it to the same extent as if made by a resolution of the board of directors."

Wakefield Bank vs. Truesdale Bank. 55 Barb. 602.

Paterson vs. Syracuse National Bank, 80 N. Y. 82; 36 Am. Rep. 582.

Lloyd vs. West Branch Bank, 15 Pa. State 172; 53 Am. Dec. 581.

"Acts within the scope of the bank manager's duties are not ultra vires and the bank is liable therefor."

First Nat. Bk. vs. Brooks, 22 Ill. App. 238.

"The acting head of the corporation, whether it is the president, vice president, cashier or general manager, through whom and by whom the general and usual affairs of the corporation are transacted which custom or necessity has im-

posed on the officer—such acts being incident to the execution of the trust reposed in him—may be performed by him without express authority; and in such cases it is immaterial whether such authority exists by virtue of his office, or is imposed by the course of business as conducted by the corporation."

Cox vs. Robinson, 27 C. C. A. 120, 82 Fed. 277.

A cashier's act, within the scope of the ordinary course of business, is binding upon the bank, though he was acting beyond the scope of the express authority conferred by it.

First Nat. Bk. vs. First Nat. Bk., 116 Ala. 520, 22 South 976.

All customary acts of the agent of a banking corporation are binding upon it.

Eastman vs. Coos Bank, 1 N. H. 23.

The cashier, or other executive officer of a bank has such powers as enable him to conduct the financial operations of the bank in the legitimate business of banking, such as the issuance of certificates of deposit.

See Tiffany on Banks and Banking, p. 321.

The power of the cashier to issue certificates of deposit is well recognized.

Cochecho Nat. Bank vs. Haskell, 51 N. H. 116, 12 Am. Rep. 67.

The president of a bank being its executive head under the usages and customs of modern banking, the rule that his power is limited to transactions expressly authorized by the directors no longer obtains.

Bartlett Estate Co. vs. Fraser, 11 Cal. App. 373, 105 Pac. 130.

The vice president of a bank who is in charge thereof has authority to bind the bank by extending the time of the payment of a demand note for a specified time and for a specified consideration, and suspending the right to sell collateral until the expiration of the extended time.

Wyckoff, Church & Co. vs. Riverside Bank, 119 N. Y. Supp. 937.

The cashier of a bank has general authority to discount and rediscount paper owned by the bank, and to sell and assign paper owned by it for a valuable consideration.

First State Bank's Receiver vs. Farmers' Bank, 155 Ky. 693, 160 S. W. 250.

On a question of the authority of a bank cashier to issue a specie certificate of deposit to a person who has no specie on deposit, similar acts, frequently done by the cashier, are admissible.

Robinson v. Beetle, 20 Ga. 675.

A bank, whose teller is authorized to certify checks is bound to an innocent holder by his certification. Although the drawer had no funds, and on this account the teller exceeded his actual authority.

Meads v. Merchants' Bank, 25 N. Y. 143, 82 Am. Dec. 331.

Hill v. Nation Trust Co., 108 Pa. St. 1, 56 Am. Rep. 189.

Evidences of debt in the ordinary course of business may be accepted and credited by a bank as the equivalent of money, in which case it becomes the owner of the paper, although it may charge dishonored paper back to the depositor.

Lummus Cotton Gin Co. v. Walker,, 70 South. 754.

SPECIFICATION ON ERROR NO. 2.

This is covered sufficiently in the brief of the receiver appellant, so will be passed in the brief.

SPECIFICATION ON ERROR NO. 3.

The trial court held that Gilchrist and Daubney had no authority to make the loan to Hays, or to extend credit to the Olympia Bank and Trust Company. This will be discussed under several heads:

First—The loan was a valid one. (See discussion under Specification of Error No. 1.)

Second—The loan or credit extended was not unlawful. The United States National had a right to loan Hays $12,500, and the Union Loan & Trust Company had a right to loan him $24,050. But even if the United States National had loaned the whole amount to Hays directly, and it is only the Hays notes that are in question, as all the directors of the United States National were satisfied with the other notes, yet an excessive loan to Hays by the United States National was not a void loan. The bank officers might disregard the statute in making the loan, yet the contract would be enforcible.

"A violation of Sec. 5200 Rev. St., prohibiting a national bank from loaning more than ten per cent of its capital to any one person or corporation can be taken advantage of only by the government."

Union Mining Co. v. Rocky Mt. Bank, 96 U. S. 640.

Maryland Trust Co. v. Nat. Mechanics Bank, 102 Md., 608; 63 Atl. 70.

Roe v. Bank of Versailles, 167 Mo. 406; 67 S. W. 303.

Portage First Nat. Bank v. Norwood State Bank, 15 N. D. 594; 109 N. W. 61.

Weber v. Spokane Nat. Bank, 64 Fed. 208.

Shoemaker v. Nat. Mech. Bank, 1 Hughes (U. S.) 101; 21 Fed. Cases No. 12, 801.

Maryland Trust Co. v. Nat. Mech. Bank, 102 Md. 608.

Stewart v. Nat. Union Bank, 2 Abb. (U. S.)

Wyman v. Citizens' Nat. Bank, 29 Fed. 734.

Mills County Nat. Bank v. Perry, 72 Iowa 15.

Corcoran v. Batchelder, 147 Mass. 541.

Allen v. Xenia First Nat. Bank, 23 Ohio St. 97.

Portland Nat. v. Scott, 20 Ore. 421.

O'Hare v. Titusville Second Nat. Bank, 77 Pa. St. 96.

Bly v. Titusville Second Nat. Bank, 79 Pa. St. 453, and other cases galore.

See especially text in Bolles, The National Bank Act, Annotated, P. 72, Sec. 51.

The receiver of a national bank succeeds to no right beyond those which could have been enforced by the bank, its stockholders or creditors. He is not entitled to have a contract made by the bank, and which has been executed, set aside on the ground merely that it was untra vires.

3 Michie, Banks and Banking, p. 2009, citing *Brown v. Schleier,* 55 C. C. A., 118 Fed. 981, affirmed in 194 U. S. 18.

Loans to any person or company in excess of 10 per cent. of the capital stock of a national bank are not void, and in an action to recover such loans the defendant cannot interpose the defense that they were in violation of the national bank act.

Union Gold Hill Min. Co. v. Rocky Mountain Nat. Bk., 96 U. S. 640.

A note is not illegal because at the time it was discounted by the association the maker was indebted to the association in a sum equal to more than one-tenth part of its capital.

O'Hare v. Second Nat. Bk., 77 Pa. St. 96.

The right of government to forfeit the bank franchise for violation of the statute does not render an excessive loan void so as to preclude the right of the bank to recover thereon.

Shoemaker v. Nat. Mechanics' Bk., 2 Abb. (U. S.) 416. See, also, Stewart case, 2 Abb. (U. S.) 424.

Third—The loan was made with notice to all the directors. It must be admitted that Gilchrist, a director, knew of it; that Daubney, a director, knew of it. It must be assumed as a fact that Charles Gilchrist, the father of C. S. Gilchrist, a director, and president of the bank, knew of it; he was in the

bank as an officer of the bank and was not produced as a witness at the trial.

Therefore, three directors knew of the deal. Only two directors deny knowing anything about the loan to Hays—Directors Dysart and Vaness. There were only the five directors—Dysart was the second vice president as well as a director, and according to his own testimony was active in bank's affairs.

It will be presumed as a matter of law that Dysart and Vaness knew of the whole transaction.

> "Acts of the cashier must be considered as done with the full knowledge of the bank where the transactions fully appear on the books of the bank."
>
> *Deposit Bank of Carlisle v. Fleming,* 44 S. W. (Ky.) 961.

Knowledge of one director acting for the bank is knowledge to the board. (See 1 Michie Banks & Banking, p. 843, and note 25.)

> "When he is not acting in his own interest and has knowledge that a note offered for discount was procured by fraud, it is imputed to the bank."
>
> Bolles' Nat. Bank Act, Anno. (4th Ed.) 105.

Knowledge of a director in his official capacity is knowledge to the board.

Union Bank v. Campbell, 23 Tenn. (4 Hump) 394.

Bank v. Rhea, 59 S. W. (Tenn.) 442.

Sixth Ward Bank v. Stearns, 148 N. Y. 515; 42 N. E. 1050.

Notice to a director of a bank of facts affecting the character of negotiable paper is notice to the bank.

Clerks' Savings Bank v. Thomas, 2 Mo. App. 367.

"But notice to a bank director, or knowledge obtained by him, while not engaged officially in the business of the bank, will be inoperative as notice to the latter.

"In case of a joint agency (e. g., the directors of a bank), notice to either, while engaged in the business of his agency, is notice to the principal."

United States v. David, 2 Hill (N. Y.) 451.

Crooks v. People's Nat. Bank, 72 N. Y. App. Div. 331.

"Where two members of an insolvent firm are president and cashier of a bank their knowledge of the insolvency of their firm is the knowledge of the bank."

Nisbit, Assignee, v. Macon Bank & Trust Co., 12 Fed. 686.

Notice to officers of a bank acting as such is notice to the bank.

Md. Trust Co. v. Nat. Mech. Bk., 102 Md. 608.
National Security v. Edward F. Cushman, 121 Mass. 490.

Here it is held that:

"If a director of a bank, who acts for the bank in discounting a note, has knowledge that the note was procured by fraud, the bank is affected by his knowledge."

"Actual Knowledge Not Essential to Liability: Actual knowledge of irregularities, however, is not necessary, since it is the duty of bank directors to use ordinary diligence in acquiring knowledge of the business of the bank."

1 Michie Banks and Banking, p. 339, Sec. 57 (1a).

The authorities in support of the proposition here advanced are so numerous the writer is bewildered in the order in which they should be stated.

The great work of Michie on Banks and Banking, page 843, says:

"Where the director acts for his bank in a business transaction, either individually or as a member of the board of directors, knowledge which he may have obtained in relation thereto is

binding upon and imputable to the bank as a director is bound to communicate such knowledge to his bank."

It is not contended that knowledge obtained in a private capacity by one director is notice to the board, but knowledge of a banking transaction by one director is knowledge of all. That the principal is liable for all acts of the agent within the scope of the agent's authority is, of course, beyond dispute, and the bank cashier within the scope of his customary activities is the bank itself.

"The cashier of a bank is the financial officer thereof, and his agreements in behalf of his principal in all matters relating to its business of banking are binding upon it to the same extent as if made by a resolution of the board of directors."

Wakefield Bank v. Truesdell, 55 Barb. 602.
Patterson v. Syracuse Nat. Bank, 80 N. Y. 82.
Lloyd v. West Branch Bank, 15 Penn. St. 172.
Michie Banks & Banking, 711.

The whole transaction appeared on the books of the United States National Bank and the president, who was a director, the vice president, who was the general manager and director, the cashier and director were in the bank all the time; in fact, Dysart, "vice president and director," was there most of the

time—all the officers and all the directors except Vaness. All but Vaness were devoting their whole time to the bank's affairs and the books of the bank open to them, and the books showed the whole transaction. (See Trans. of Rec., p. 158.)

"A cashier has authority to bind his bank and *entries made by him,* even though relating to forged paper *charge the bank with notice.*"

1 Michie, Banks and Banking, 768.

"The directorate may be deceived by its agent's transactions, *but the directorate is presumed to have notice of all transactions appearing upon the books in regular order.*"

1 Michie, Banks and Banking, 768.

"The acts of the cashier must be considered as done with the full knowledge of the bank where the transactions fully appear on the books of the bank."

Deposit Bank of Carlisle v. Fleming, 44 S. W. (Ky.) 961.

Furthermore, directors are estopped.

"Directors are estopped to deny action of officers where directors have known course of officers for a long time."

First Nat. Bank v. Gaddis, 31 Wash. 596.

Wing v. Com. Sav. Bank, 103 Mich. 565, 61 N. W. 1009.

"When directors of a bank permit an officer to hold himself out to the public as being invested with absolute power to manage and conduct its affairs the bank cannot repudiate contracts made by him."

Cox v. Robinson, 82 Fed. 277.

But where a bank issued a certificate of deposit for the accommodation of the depositor, and another loaned money to the depositor on the faith of the certificate, though with knowledge that it was accommodation paper, the bank is liable therefor.

Holland Trust Co. v. Waddell, 75 Hun. 104, 26 N. Y. Supp. 980.

And when a certificate of deposit, stating that a depositor had deposited in the drawing bank a certain amount of money, is delivered to and accepted by a bank named therein as payee, and the amount thereof placed by payee bank to the credit of the beneficiary named, a receiver of the drawing bank is estopped to claim that no consideration was received by the bank for the certificate.

Armstrong v. American Exch. Nat. Bk., 133 U. S. 433.

The right to issue certificates of deposit is regarded as an incidental right to banking. * * *

A certificate of deposit is evidence of so high and satisfactory character as to the sum therein named and deposited, that to escape its effect and the amount claimed therein, the bank must overcome it by clear and satisfactory evidence.

Magee on Banks, p. 377, citing *First Nat. Bank v. Myers,* 83 Ill. 507.

A valid certificate of deposit is prima facie evidence of liability (*Am. Nat. Bank v. Presnall,* 58 Kan. 69, 48 Pac. 556), and it seems that it is conclusive that the money was received on deposit (*Carroll v. Corning State Sav. Bank,* 136 Iowa 79, 113 N. W. 500.) * * * The certificate is an acknowledgment that the bank had the sum of money specified therein on its books to the credit of the plaintiff, and the burden of proof is on it to show that it has in some way discharged the liability. (*Cushman v. Illinois Starch Co.,* 79 Ill., 281.) The holder of a certificate of deposit payable in "current funds," who is otherwise entitled to recover thereon, is entitled to judgment for the amount specified in the certificate without proof of value. (*Fallon v. Safety Banking, Etc., Co.,*

45 Pa. Super. Ct. 193.) The maker of a certificate of deposit cannot overcome its effect as evidence of the deposit, except by clear and satisfactory evidence. (*First Nat. Bank v. Myers,* 83 Ill. 507).

2 Michie, Banks and Banking, Pp. 1353-54.

It is held in *Pacific Trust Co. v. Dorsey,* 72 Cal. 55, 12 Pac. 49, that the note of a stockholder, given to a bank as security for the payment of his first stock installment, was "property actually received," within the constitutional provision that stock could not be issued "except for money paid, labor done, or property actually received," and that the bank was authorized to issue its stock to such subscriber.

Fifth—There was a valuable consideration. Hays gave his note, which the court finds was worthless, but Gilchrist and Daubney did not find so. Gilchrist says he expected Hays to take only ten thousand dollars' worth of stock, and not to exceed fifteen thousand. (Trans. of Rec. p. 126.) They probably split the difference, and the one note for $12,500 represented that agreement. The rest of Hays' stock was to be sold to other prospective stockholders. But Gilchrist got Hays' notes, one of which he was willing to take. Later on when the stock was issued he got the stock as collateral. Hays not only sent his own

stock but, which he had not authority to do, the stock of others.

> "A national bank may take stock in another corporation as collateral."
>
> *Westminster Nat. Bank v. New Eng. Electrical Works,* 73 N. H. 465; 62 Atl. 971. 111 Am. St. Rep. 637; 3 L. R. A. (N. S.) 551.
> *Schofied v. State Nat. Bank,* 38 C. C. A. 179; 97 Fed. 282.

The United States National got $2,000 in cash, $11,450 in good notes, for which Gilchrist said he did not want any security, a $12,500 note which was not objectionable to Gilchrist, and the $24,050 account in the Union Loan & Trust Co., based on a note that Hays was to take up when he disposed of some of his stock to some one else from his allotment. This was on the 20th day of August, 1914. About ten days after that Hays sent his stock as collateral. Whether these notes were good bankable notes is not for the court to enquire. The banking officers may have used poor judgment, but that goes with the business.

Gilchrist was the leading officer in the Union Loan & Trust Co., a state bank of $100,000 capital. He had the right to put the note of Hays in that bank. So the transaction was not a bad one so far as the United States National was concerned. It had the

$2,000 in cash, the $11,450 in good notes, a $24,050 note of Hays backed by the Union Loan & Trust Co., and Hays' note direct for an amount for which Gilchrist was willing to carry him.

In addition to all this, the United States National got in ten days some forty thousand dollars in actual cash from the deposits of the Olympia bank.

It was a time when the United States National need cash. For the credit given the Olympia Bank and Trust Company, in ten days then the United States National had $11,450 in notes deemed good, a $24,050 note indorsed by the Union Loan & Trust Co., a $12,500 note of W. Dean Hays which Gilchrist was willing to carry indefinitely, and over $40,000 in cash.

Under the act then in force, 15 per cent. was required to be held in reserve, so out of this transaction $13,500 was all the United States National was required to keep on call. Thus she built up her cash reserve $26,000 or $27,000.

Gilchrist said they were trying to build up their cash reserve. (See re-direct examination of Gilchrist, Trans. of Rec., p. 123.)

Dysart said they were trying to build up their cash reserve. (See Trans. of Rec., p. 113.)

The United States National Bank profited very materially by the transaction.

Sixth.—The directors approved of the transaction by a majority of them actually knowing of the arrangement, and all of them knew it constructively by the whole record of the transaction being on the books of the bank. This first occurred on Aug. 20, 1914, then each day thereafter when remittances came to be credited to the Olympia Bank and Trust Company, and especially when, about Sept. 1, 1914, the stock was received as collateral, but absolutely on September 14th, when Dysart and Vaness, the other two of the five directors, ordered Gilchrist and Daubney to come to Olympia and get Hays to draw on the credit of the Olympia Bank and Trust Company to take up Hays' notes. They approved all the rest of the transaction except the Hays' notes; they approved the credit extended and deposits received, else they would not have ordered drafts drawn on it. They were going over the books. There can be no excuse now that they had no notice. They not only had notice then, but they ordered Gilchrist and Daubney to go to Olympia in the night time and get Hays to draw on his own bank to pay his private debt. They ordered a rape on the funds of the Olympia Bank and Trust Company to benefit them.

By this act they were guilty of a felony under the laws of the State of Washington, or they did not intend the notes to be paid. Both propositions will be

discussed, the criminal first. It is inconceivable to think these men—George Dysart, prominent lawyer and business man, and J. A. Vaness, logger and sawmill man, conspired with the other directors of the United States National and W. Dean Hays, whereby Hays was to embezzle the funds of the Olympia Bank and Trust Company to pay his private debt. Yet if these men did order Gilchrist and Daubney to come to Olympia in the night time and get Hays to do as is claimed, they did actually commit a felony. As is said in

Maryland Trust Co. v. Mech. Nat. Bank, 102 Md. 616:—

"Whilst the gentlemen who were concerned in this transaction never dreamed for a moment that they were engaged in an undertaking which was unlawful because in the teeth of a general statute, and plainly subversive of a sound and virile public policy as herein later on pointed out; and whilst a purpose to do wrong was never in the most remote way contemplated by any of them; still men are held by the law, generally, to have intended the natural, and always to have intended the necessary, immediate and inevitable consequences of their voluntary acts; and however innocent their motives may have been, they must be treated, when their conduct and contracts are being dealt with in such proceedings as the one before us, precisely as though they designed to accomplish the results which necessarily, immediately

and inevitably flowed from what they deliberately did, pursuant to a contract to do the thing so done. A corrupt intent is not necessary. 15 Am. & Eng. Ency. L. 936."

Hays testifies that it was not the intention that his note should be paid—that the drafts were merely to fool the United States Bank examiner; and a jury in the state courts of Washington so found in a criminal action against Hays for misappropriation of bank funds.

This phase of the question does not enter into the case only as showing that all the directors of the United States National Bank knew of the whole transaction and approved of it, for at this meeting on the evening of the 14th of September the books of the United States National Bank were before them. They could see that on the 31st day of August the $12,500 note had been charged off. (See Trans. of Rec., p. 158.) This was 15 days before the 14th day of September. They also could see that the United States National Bank had nothing to do with the $24,050 note that had been negotiated through the Union Loan & Trust Co.

Mr. Gilchrist testifies in his direct examination, as follows:

> "The $24,050 note was charged to the Union Loan & Trust Co. I directed that it be charged

to the Union Loan & Trust Co., and credited to the Olympia Bank and Trust Company." (See Trans. of Rec., p. 125.)

They could see and knew that the United States National Bank did not have the $24,050 note.

There is further proof of this; the two drafts that were issued were never negotiated; the $24,050 draft has never been seen since that date so far as the receivers of the banks have been able to find. Inasmuch as the United States National Bank did not have the $24,050 note, it had no use for the draft. The $12,500 draft was never negotiated and was received by the state bank examiner after the close of both banks, without any marks or signs that it ever had been negotiated; in fact, it had not. It was not returned to the Olympia Bank and Trust Company in due course and therefore the Olympia Bank and Trust Company had no notice of them.

A draft not returned in due course, but held until after failure of drawing bank, is not binding on receiver of bank against which it is drawn.

Wood v. Green, 131 Tenn. 583, 1175, S. W. 1139.

This shows that the directorate of the United States National Bank approved of the whole transaction; that its cash reserve had been increased

markedly by the organization of the Olympia Bank and Trust Company; and that the cancellation of the note of W. Dean Hays for $12,500 was not intended. The directors of the United States National had no control over the $24,050 note.

Of course, all the officers of the United States National were grasping at straws to save their institution; they were even willing to commit what would appear on the face as felony in their desperation and in the hope that it would finally work out.

In all this, the United States National Bank was amply justified in extending the credits to the Olympia Bank and Trust Company on the evidences of values it had received. Mr. Gilchrist testified that all the other notes were good and that the stock sent down was collateral only to the Hays' notes, he, being an officer in both banks, could, in dealing with Hays, take the collateral for both notes. He said:

> "It was our understanding that we were to receive stock as collateral for the Hays' notes. My understanding was that the stock was to be collateral for the two Hays' notes; not for the others. We did not ask for security on the other notes for $11,450; I took into consideration the fact that he had associated with him the highest state officials and men who were held in high esteem by me personally. I was willing to take

all of the notes given me at the time, except the Hays' notes, without any security at all." (See Trans. of Rec., p. 127).

SPECIFICATION ON ERROR NO. 4.

Under the fourth assignment of error, the intervenors complained because the trial court returned to the receiver of the Olympia Bank and Trust Company the $11,450 in notes. That these notes should be returned was part of our prayer, provided that the full amount of actual cash deposits made in the United States National Bank by and through the institution known as the Olympia Bank and Trust Company, be adjudged a preferred claim. We wanted full rescission and full restitution. This preference will be discussed under the next specification.

SPECIFICATION ON ERROR NO. 5.

After the receiverships were established, intervenors found that most of the stockholders of the Olympia Bank and Trust Company had been misled as to the source of wealth of W. Dean Hays, and being desirous of early meeting the depositors of the Olympia Bank and Trust Company and settling with them; and also, ascertaining that some of the stockholders, other than W. Dean Hays, and including him, could not be made liable on their stock subscriptions, at least not to the statutory limit, sought to present to the court what seemed like an equitable

compromise. Notwithstanding the fact that the cashier of the United States National Bank had certified under oath that the Olympia Bank and Trust Company had $50,000 on deposit in the United States National Bank, and that the state bank examiner of the state of Washington had certified that he had carefully examined the assets of the Olympia Bank and Trust Company, and found that such bank did have actual paid-up capital stock of $50,000, and that such capital stock was on deposit in a reliable and reputable bank, the intervenors were willing to make some sacrifice in the name of equity and fair dealing and so set forth in their complaint that the Olympia Bank and Trust Company was organized through conspiracy to defraud, which conspiracy was fostered by the officers of the United States National Bank and W. Dean Hays, as the agent of the United States National Bank. Intervenors are here now urging this court that if it should find that the trial court was justified in finding there was fraud against the United States National Bank in the organization of the Olympia Bank and Trust Company, and that the Olympia Bank and Trust Company was not legally organized, then we ask that the decree of the lower court be modified to the extent that the United States National Bank should not be permitted to benefit by its fraud, or a fraud of its officers, but that all the actual cash deposited in the United States National

Bank, as a result of this fraudulent conspiracy, should be declared a trust fund and be returned to the receiver representing the creditors of the Olympia Bank and Trust Company.

> "A person who has been fraudulently induced to enter into a contract, has the choice of several remedies. He may repudiate the contract, and tendering back what he has received under it, may recover what he has parted with, or its value."
>
> 20 Cyc. 87 C.
>
> Prompt Disaffirmance Necessary. — "The person who has been misled is required, as soon as he learns the truth, with all reasonable diligence to disaffirm the contract, or abandon the transaction, and give the other party an opportunity of rescinding it and restoring both of them to their original position."
>
> Pomeroy Equi. Jur. 3rd Ed., Sec. 897.
>
> "All persons who are engaged in the perpetration of a fraud are liable for the damages occasioned thereby."
>
> 20 Cyc. 87 C.

As stated above, there was no offer of rescission until one year and three months after the closing of the banks, and then only in open court near the close of the trial of this cause. But no offer of restitution.

"When the agent acts beyond and even in direct opposition to his express authority, but within the scope of his implied authority—that is, within the apparent authority contained in and conferred by the terms of his commission, or the nature of his official functions or employment, or appearing from a prior course of dealing with or on behalf of his principal, or from any other mode of his being held out to the world as appearing to possess the authority, *and the principal is personally innocent of such fraud —the principal can not acquire and retain any benefit obtained under such circumstances from the fraud, representations, or concealments.*"

Pomeroy Equi. Jur., 3rd Ed., Sec. 909.

"There are certain incidents which are requisite to the exercise of the jurisdiction, and to the granting of any relief, and which result partly from the equitable conception of fraud itself, or its effects upon the rights and liabilities of the two parties, and partly from the theory concerning remedies and their administration. These incidental requisites are referable, therefore, to the following general principles:

1. Fraud does not render contracts and other transactions absolutely void, but merely voidable, so that they may be either confirmed or repudiated by the party who has suffered the wrong.

> 2. If he elects to repudiate, and seeks for a remedy, then equity proceeds upon the theory that the fundamental transaction is a nullity; *and it administers relief by putting the parties back into their original position, as though the transaction had not taken place,* and by doing equity to the defendant as well as to the' plaintiff.'
>
> Pomeroy Equi. Jur., 3rd Ed., Sec. 915.

If Gilchrist, Daubney and Hays conspired to establish a bank in the city of Olympia not in conformity with the laws of the state of Washington, they practiced a fraud upon the state of Washington, they deceived the state bank examiner and, indirectly through the state bank examiner, because of the issuance of his certificate to the effect that the stock of the Olympia Bank and Trust Company had been fully paid up in cash and that such capital was on deposit to the amount of $50,000 in a reputable bank, deceived the depositors and creditors of the Olympia Bank and Trust Company by inducing them to trust an institution that had no existence.

And if this is the case, the court should not permit the perpetrators of that fraud to receive the benefits.

The trial court held that the deposits made by the patrons of the Olympia Bank and Trust Company and transferred to the United States National Bank were

made in due course and that the Olympia Bank & Trust Company was entitled to only a general claim. See the results of this. Under the court's finding, the Olympia Bank and Trust Company could not have been organized, could not have received a charter had it not been for, as he found, the fraud of Gilchrist and Hays. Because of this fraud, the United States National Bank received in actual cash upwards of $40,000. But assuming that it received practically only $25,000, its cash was enhanced that much. The bank is paying its creditors 50 cents on the dollar, or thereabouts, and hence, back to the Olympia Bank and Trust Company a little over $12,000, the depositors of the United States National Bank thereby profiting to the extent of over $12,000.

> "The remedy which equity gives to the defrauded person is most extensive; it reaches to all those who are actually concerned in the fraud, all who directly or knowingly participated in its fruits and all those who derive title from them, voluntarily or with notice. 'A court of equity will wrest property fraudulently acquired, not only from the perpetrator of the fraud, but', to use Lord Cottenham's language, 'from his children and his children's children, or, as elsewhere said, from any person amongst whom he may have parceled out the fruits of his fraud.' "
>
> Pomeroy's Equi. Jur., Sec. 918.

We contend that the depositors of the United States National Bank have no right to benefit at the expense of the depositors of the Olympia Bank & Trust Company if the Olympia Bank and Trust Company was in any way fraudulently established.

A constructive trust was thereby created in favor of the depositors of the Olympia Bank and Trust Company.

> "Constructive trusts include all those instances in which a trust is raised by the doctrines of equity for the purpose of working out justice in the most efficient manner."
>
> Pomeroy Equi. Jur., Sec. 1044.

It seemed to the intervenors that, in view of the fact that, according to the books of the United States National Bank between August 20 and September 1, the 10 first days of the existence of the Olympia Bank and Trust Company, $26,632.28 had been received from the Olympia Bank and Trust Company, the lower court was in error in holding that this large amount of money was deposited there in due course of business. The whole proceedings show that there could have been no Olympia Bank and Trust Company, or at least none for some days yet to come, had it not been for the United States National Bank. It's impossible to say when the Olympia Bank and Trust Company would have been or-

ganized, and if organized only by the connivance of the officers of the United States Bank, then equity should at least not favor the depositors of the United States National Bank.

SPECIFICATION ON ERROR NO. 6.

This specification is covered in the other specifications.

SPECIFICATION ON ERROR NO. 7.

Intervenors urge that there was approval of all from the very inception by at least three directors of the United States National, constructive approval of all the directors because the whole transaction was on the books of the company, and that it was at least approved on September the 14th, when a minority of the directors rescinded it only in part, but did not offer restitution.

Notwithstanding, as the lower court found, there was equal negligence, we contend that the directors of the United States National Bank had knowledge of the negligence on the part of their officers, while the organizers and directors of the Olympia Bank and Trust Company had no such knowledge. (See testimony of C. S. Reinhart, Trans. of Rec., p. 99; testimony of W. T. Cavanaugh, Trans. of Rec., p. 100; testimony of Chas. E. Hewitt, Trans. of Rec., p. 101; testimony of I. M. Howell, Trans. of Rec., p. 104; see also testimony of Gilchrist, Trans. of Rec., bottom of page 126 and top of page 127.)

But notwithstanding any negligence on the part of the trustees of the Olympia Bank and Trust Company, the directors of the United States National Bank, after the two minority directors had learned of what they deemed was fraud, should have rescinded in total.

> "*While a party entitled to relief may either avoid the transaction or confirm it, he cannot do both; if he adopts a part, he adopts all; he must reject it entirely if he desires to obtain relief.* Any material act done by him, with knowledge of the facts constituting the fraud, or under such circumstances that knowledge must be imputed, which assumes that the transaction is valid, will be a ratification."
>
> Pomeroy Equi. Jur., 3rd Ed., Sec. 916.
>
> "The most important practical consequence of the two principles above mentioned is the requisite of promptness. The injured party must assert his remedial rights with diligence and without delay, upon becoming aware of the fraud."
>
> Pomeroy Equi. Jur. 3rd Ed., Sec. 917.

The directors of the United States National, not rescinding in total, if rescinding at all, and delaying for more than a year and until the trial of this cause to rescind in part, was in fact an approval of the whole transaction.

The books of the Olympia Bank and Trust Company appeared to be reliable, and, in fact, as far as the bank was concerned, were. (See testimony of Receiver McKinney, Trans. of Rec., p. 60.) Intervenors also contend that the certificate of the bank examiner was conclusive. The law requires the state bank examiner to examine the capital and assets of a prospective bank and trust company:—

> "All of which shall be paid in cash before any trust company shall be authorized to transact any business." (Sec. 3346 Rem. Codes and Stat. of Wash.)
>
> "Provided, however, That before the corporation shall be authorized to transact business in this state, other than such as relates to its formation and organization, the bank examnier shall examine, or cause to be examine, in order to ascertain whether the requisite capital of such corporation has been fully paid in cash, and if it appears from such examination that such capital stock has not been fully paid in cash, a certificate of authorization shall not be granted; and no such corporation snall commence business until such certificate of authorization has been granted; but when it shall appear to the bank examiner that the entire capital stock has been paid in, and that such trust company is lawfully entitled to commence business, he shall give to such company a certificate under his hand and seal that such company is duly and legally organized under this act as a trust com-

> pany, and authorized to transact business as such trust company in this state." (Rem. Codes and Stats. of Wash., Sec. 3348.)

Under the statute quoted in the former part of this brief, this certificate speaks verity. The directors of the United States National Bank knew this certificate was obtained upon the affidavit of the cashier and director of the United States National Bank, in which he said:

> "That the Olympia Bank and Trust Company has on deposit with the United States National Bank, Centralia, Wash., fifty thousand ($50,000.00 00-100) subject to the *order* of the said Olympia Bank and Trust Company; that said money is deposited preliminary to the organization of the aforesaid bank; *that said deposit is unconditional and is subject to check only in the usual course of banking business.*" (See Trans. of Rec., p. 170.)

And knowing this, they never notified the state bank examiner that they wished to withdraw this certificate or affidavit. They let him continue the operations of the Olympia Bank and Trust Company until the directors of the Olympia Bank and Trust Company, themselves, after the failure of the United States National Bank, formally asked the state bank examiner to take charge of the Olympia Bank and Trust Company.

"The certificate then of the bank examiner taken from the books of the bank, bound the bank."

Espey v. Bank of Cincinnati, 18 Wall. 604.
Polk v. Bank of Albion, 59 Barb. 226.

"The certificate of the cashier will bind the bank in favor of innocent third persons upon the principle of *estoppel in pais,* even if the certificate be not true."

Morse on Banks and Banking, Sec. 155 (i).

"The comptroller has jurisdiction to determine as to the completeness of the organization, and his certificate is not open to collateral attack, and is conclusive for purposes of litigation."

Casey v. Galli, 94 U. S. 673.
Citizens' Nat. Bk. v. Gt. Western Elevator Co., 13 S. D. 1, 82 N. W. 186.

"When any judicial or official act is shown to have been done in a manner substantially regular, it is presumed that formal requisites for its validity were complied with."

Stephens, Evidence, Art. 101.

"The principle is, that where acts are of an official nature or require the concurrence of official persons, a presumption arises in favor of their regularity."

Jones, Evidence, Sec. 30 (25).

"It is a rule of very general application that where an act is done which can be done legally only after the performance of some prior act, proof of the latter carries with it a presumption of the due performance of the prior act."

Knox County v. Ninth Nat. Bank, 147 U. S. 91,

See 9 Encyc. Evidence, p. 944.

"Where a banking corporation is attempted to be formed under a general law, it is often said that the requirements of the law must be strictly followed. But this is only relatively true. It will appear that objections of this character, as a general rule, can be urged only in favor of the state in a direct proceeding to attack the incorporation. * * * The state governs as to how the capital stock shall be paid, whether in money or otherwise. If the statute is silent on the subject, and the doctrine of payment 'in money's worth' is held in the particular jurisdiction, there seems to be no reason why payment for the capital stock should not be made in property, provided such property was proper for use in the business. The statutes usually require the issuance of a certificate by proper authority where the organization is made under general laws, *which certificate is always evidence of due incorporation.*"

Zane, Banks, Sec. 19.

"The corporate existence may come directly in question or indirectly. It comes directly in issue when a suit is brought by the state to forfeit charter. * * * But when the due incorporation of a bank comes collaterally in question, a very different rules applies. * * As to anyone who has contracted with the corporation as such, the fact of due incorporation is conclusively presumed. * * * When collaterally attacked the existence of the corporation may be proved in favor of the corporation by the certificate of proper authority, and this certificate is conclusive." (Citing *Casey v. Galli,* 94 U. S. 673; *Keyser v. Hitz,* 2 Mackey, 473; *Thacker v. West River Bank,* 19 Mich. 196.)

Zane, Banks and Banking, Sec. 23.

Appellant cites the case of *Kimball as Receiver vs. Farmers and Mechanics' Bank,* 60 Wash., 611. This case is almost a perfect parallel to the case at bar, except, possibly, that all the incorporators of the State Bank of Washington knew of the irregularity of their corporation. In the city of Spokane was the Farmers & Mechanics' Bank; there were four persons who desired to establish a bank in Spokane, and under the law for the establishment of a bank without trust features, only three-fifths of the capital stock is required to be paid in cash. These incorporators received a certificate from the Farm-

ers & Mechanics' Bank to the effect that there was on deposit in the Farmers & Mechanics' Bank a requisite capital which, together with the affidavits of the incorporators which authorized them to incorporate the State Bank of Washington, gave them their charter. The incorporators had no funds in the Farmers & Mechanics' Bank, or at least insufficient funds, but the cashier accepted their checks and held them. Later on, against the credits of the State Bank of Washington, the cashier of the Farmers & Mechanics' Bank charged these checks. This was not authorized by the directors of the State Bank of Washington.

There is one more difference between this case and the case at bar, and that is, the court finds there was even no consideration for the acceptance of the checks of the incorporators of the State Bank of Washington, as there appears to be in the case at bar. Yet, notwithstanding that, and notwithstanding the fact that the directors of the Farmers & Mechanics' Bank, as a board, knew nothing of such credit extended to the incorporators of the State Bank of Washington, the court found that the Farmers & Mechanics' Bank, in an action brought by the receiver of the State Bank of Washington after it had become insolvent, was bound by the action of their cashier and president in giving this certificate for

the incorporation of the State Bank of Washington. The supreme court of Washington adopts the finding of the trial court as its opinion in that case, and the facts in that case are much more favorable to the defendant in the case at bar than are the facts in its behalf in this case. Respectful attention to this case is particularly urged.

It goes without saying that Hays could not use the funds of the Olympia Bank and Trust Company to pay his obligation, even with the consent of the board of directors. Statute clearly prohibits it, providing that no loans whatsoever shall be made to any officer:

> "No trust company now in existence or hereafter organized shall make any loan to any officer, stockholder or employee from its trust funds, and such trust company shall not permit any officer, stockholder or employee to become indebted to it in any way out of its trust funds; any president, vice-president, director, secretary, treasurer, cashier, teller, clerk or agent of any such corporation who knowingly violates this section, or who aids or abets any officer, clerk or agent in any such violation, shall be guilty of a felony and punished accordingly." (L. '03, p. 372, Sec. 6.) Rem. Codes and Stat. of Wash., Sec. 3351.

The officers of the United States National Bank must have known this, or should have known it, and, as argued before in this brief, it was not intended that Hays should pay his notes by this transaction, but even if he did intend so and the officers of the United States National Bank so intended, it could not be charged to the Olympia Bank and Trust Company.

> "The cashier, whatever may be his general authority as to making loans, cannot bind the bank by lending its money to himself."
>
> I Michie, p. 757, 126 Ga. 702.

> "Where a rule of a bank prohibits its officers becoming its debtor, a transaction between the cashier and one who acts with notice of the rule will not affect the bank."
>
> 1 Michie, p. 757, 73 Ga. 223.

> "A cashier cannot bind a bank by drawing a check to pay his individual debt."
>
> 1 Michie, p. 763.
>
> *Rankin v. Chase Nat. Bank,* 188 U. S. 557.

SPECIFICATION ON ERROR NO. 8.

The three matters in controversy were the $36,550 claimed to have been charged against our account in the cancellation of the Hays's notes; $9,500 Blumauer notes charged up to us without any notice; and cer-

tain items of cash forwarded to the State Bank of Tenino. The last item in the State Bank of Tenino is of little concern, whether we get credit on the books of the United States National Bank, or on the books of the State Bank of Tenino. An item of $9,500 the court found with us. This item included certain notes which had been charged to our account and no notice sent to us, and the notes still are in the possession of the receiver of the United States National Bank. The other item was the item of the $36,550 note, wholly an illegal transaction. Gilchrist testifies that he knew Hays could not pay his private debt.

We think, in view of these conditions, and in the bringing in of other parties against our will, we were entitled to costs against the receiver of the United States National Bank.

CONCLUSION.

Through long years of acquaintance the writer has a high regard for the trial judge, but who, however, is only human, fallible, is liable to mistakes.

The writer feels that the trial court was unconsciously impressed with the idea that unless he stemmed the tide of clamoring hordes then seeking the funds of the United States National Bank nothing would be left for the common depositors. Fortunately now this situation has changed.

This impression is garnered fro mremarks of the court, both in the court room and at chambers, and further from the opinion of the court on the petition for rehearing. In this opinion the writer feels that the court assumed facts to exist that were not in the record, and had no foundation.

This impression is garnered from remarks of the applied to them as should be applied to the directors of the United States National Bank. The trial court finds the two banks were *in pari delicto,* but we think there is nothing in th record, in reason or law to support this. When Hays had his dealings with Gilchrist about starting the Olympia bank there wasn't any Olympia Bank and Trust Company, so how could it be bound. When there was an Olympia Bank and Trust Company it had nothing suspicious before it except the affidavit of the cashier of the United States National that the Olympia bank had $50,000 on deposit subject to order absolutely, and also the findings of the State Bank Examiner in the form of his certificate that the stock had been paid for in cash, that the capital was all subscribed and the money in a good responsible bank, and that every part of the law had been complied with by the organizers of the Olympia Bank and Trust Company. This convinced the other stockholders that Hays had told the truth

when he said he had ample funds, and also convinced each that his own stock had been paid for in cash.

From that time on the directors of the Olympia bank were guided by their own books. Nothing ever appeared on their books to cause suspicion or questionable conduct. On the other hand at least a majority of the directors, in fact all the directors but one, of the United States National were in the United States National Bank all the time, and everything appeared on their books. On September 14, they formally discussed the transaction and approved it. Instead of disapproving it on that date they sent their officers out in the night time to get Hays to do an unlawful act, and on their own stationery had Hays commit a felony—and all of them. But the directors of the Olympia bank knew nothing of this. Then the United States National never negotiated the drafts; these drafts were never sent the Olympia bank, and although the directors of the United States National knew of this transaction the directors of the Olympia bank had no such knowledge, no inkling to cause suspicion until the United States National closed its doors. And yet the trial court held we were *in pari delicto.*

He exonerated the United States National and its directors for what they knew and did, and stuck the Olympia Bank and Trust Company for

WHAT ITS DIRECTORS DID NOT KNOW, COULD NOT KNOW, AND DID NOT DO. THAT IS WHY WE ARE ASKING JUSTICE AND EQUITY HERE.

Respectfully submitted,

C. WILL SHAFFER,

Intervenor and Solicitor for Intervenors.